E COPY

FILED

No. 740

In the Supreme Court of the United States

OCTOBER TERM, 1960

JACK D. MATHESON,
PETITIONER

v.

GEORGE ARMBRUST

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN OPPOSITION

ARCHIBALD COX,
Solicitor General,
Department of Justice,
Washington 25, D. C.

WALTER P. NORTH,
General Counsel,

DAVID FERBER,
Assistant General Counsel,

JOHN A. DUDLEY,
Attorney,
Securities and Exchange Commission
Washington 25, D. C.

INDEX

	Page
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statute and Rule Involved	2
Statement	2
Argument	3
Conclusion	9

CITATIONS

Cases:

American Distilling Company v. *Brown*, 51 N.Y.S. 2d 614, 184 Misc. 431, affirmed, 295 N.Y. 36, 64 N.E. 2d 347	5
Bell v. *Hood*, 327 U. S. 678	6
Beury v. *Beury*, 222 F. 2d 464, 127 F. Supp. 786	6
Brouk v. *Managed Funds*, January 13, 1961, CCH Fed. Sec. L.Rep., Current ¶ 91,000	6
Connelly v. *Balkwill*, 174 F. Supp. 49	6
Errion v. *Connell*, 236 F. 2d 447	4, 8
Fair, The, v. *Kohler Die Company*, 228 U. S. 22	6
Fischman v. *Raytheon Manufacturing Company*, 188 F. 2d 783	4
Fratt v. *Robinson*, 203 F. 2d 627	4, 7, 8
Fry v. *Schumaker*, 83 F. Supp. 476	4
Hawkins v. *Merrill, Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104	4
Hooper v. *Mountain States Securities Corporation*, 282 F. 2d 195, *certiorari denied*, No. 603 this Term	4, 6, 7
Howard v. *Furst*, 238 F. 2d 790	6, 7
Kardon v. *National Gypsum Company*, 69 F. Supp. 512	4
Mekrut v. *Gould*, 188 N.Y.S. 2d 6	5
Mills v. *Sarjem Corporation*, 133 F. Supp. 753	4

Cases—Continued

	Page
Montana-Dakota Utilities Company v. *Northwestern Public Service Company*, 341 U. S. 246	4, 5
Northern Trust Company v. *Essaness Theatres Corporation*, 103 F. Supp. 954	4
Remar v. *Clayton Securities Corporation*, 81 F. Supp. 1014	8
Robinson v. *Difford*, 92 F. Supp. 145	4
Slavin v. *Germantown Fire Insurance Company*, 174 F. 2d 799	4
Speed v. *Transamerica Corporation*, 99 F. Supp. 808, *affirmed*, 235 F. 2d 369	4
Standard Paper & Light Corporation v. *Investment Associates*, 29 Del. Ch. 593, 51 A. 2d 572	5
Textile Workers v. *Lincoln Mills*, 353 U. S. 448	8

Statutes and Rules:

Securities Exchange Act of 1934, 48 Stat. 881, as amended:	
Section 10(b), 15 U. S. C. 78j	3, 5
Section 14(a), 15 U. S. C. 78n(a)	7
Section 27, 15 U. S. C. 78aa	2, 4, 5, 8
Section 28, 15 U.S.C. 78bb	5
28 U.S.C. 1331 (62 Stat. 930, as amended, 72 Stat. 415	4, 6
General Rules and Regulations under the Securities Exchange Act of 1934:	
Rule 10b-5, 17 C. F. R. 240.10b-5	2, 3, 4, 5, 7, 8

In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 740

JACK D. MATHESON,
PETITIONER

v.

GEORGE ARMBRUST

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN OPPOSITION

The Solicitor General submits this brief on behalf of the Securities and Exchange Commission, as amicus curiae, in opposition to the petition for a writ of certiorari. The Commission appeared in the Court of Appeals in support of the position of the respondent.

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. 17-26) is reported at 284 F. 2d 670. The opinion of the District Court (Pet. 12-16) is unreported.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on November 28, 1960. The petition for a writ of certiorari was filed on February 17, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). See also Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78aa.

QUESTION PRESENTED

Whether, under the provisions of Section 27 of the Securities Exchange Act of 1934, conferring on the federal district courts exclusive jurisdiction of violations of that Act, a federal district court has jurisdiction over an action between private parties based on violations of the anti-fraud provisions of that Act and of the regulations thereunder.

STATUTE AND RULE INVOLVED

Pertinent provisions of the Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*, and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, are set forth in the petition (Pet. 2-4).

STATEMENT

According to the detailed findings of fact, which the petitioner does not dispute, the petitioner sold to the respondent at a price of $90,000 the outstanding shares of stock of the Willamette Hauling Company (the "Company") (R. 43, 44, 45). In carrying out the sale of these securities, the petitioner intentionally practiced a scheme to defraud the respondent

(R. 38, 45). The fraudulent scheme commenced with an interstate telephone call from the petitioner to the respondent inviting negotiations for the sale of the securities and continued throughout subsequent negotiations until the sale was consummated (R. 45). The scheme involved use of a false financial statement and other misrepresentations relating to the financial condition of the Company (R. 45-48). The respondent was forced to cause the Company to file a voluntary petition in bankruptcy five months after he had assumed control (R. 51, 52).

The petitioner's use of the interstate telephone in furtherance of his fraudulent scheme to sell securities was found by the District Court to be conduct in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder (R. 44). After also finding that the injury suffered by the respondent was a direct and proximate result of this violation, the District Court awarded the respondent money damages and declared void several contracts entered into in connection with the sale (R. 52-54).

The Court of Appeals affirmed, specifically holding that the district court had properly assumed jurisdiction over the action pursuant to Section 27 of the Securities Exchange Act of 1934.

ARGUMENT

The proposition that a violation of Rule 10b-5 gives rise to private rights, although of substantial importance and never passed upon by this Court, has been established in three Courts of Appeals in addi-

tion to the court below,[1] and is clearly correct. There is no conflict.

The petitioner's assertion that relief for violation of such rights may be obtained only in the state courts was either expressly or impliedly rejected in the cases just cited. The petitioner's argument that an action under the rule is not one which "arises under the Constitution, laws or treaties of the United States," as provided in 28 U.S.C. 1331,[2] ignores Section 27 of the Securities Exchange Act, which provides that "[t]he district courts of the United States . . . shall have exclusive jurisdiction . . . of all suits in equity and actions at law brought to enforce any liability or duty created . . ." by that Act or rules thereunder. It is under this section, as noted by the court below (Pet. App. 22), that jurisdiction vests.[3] Even if it

---

[1] *Hooper* v. *Mountain States Securities Corporation*, 282 F. 2d 195 (C. A. 5), *certiorari denied*, No. 603, this Term; *Fischman* v. *Raytheon Manufacturing Company*, 188 F. 2d 783 (C. A. 2); *Speed* v. *Transamerica Corporation*, 99 F. Supp. 808 (D. Del.), affirmed, 235 F. 2d 369 (C. A. 3); *Fratt* v. *Robinson*, 203 F. 2d 627 (C. A. 9), and *Errion* v. *Connell*, 236 F. 2d 447 (C. A. 9). Other cases where federal courts have assumed jurisdiction over private actions for violations of Rule 10b-5 include: *Slavin* v. *Germantown Fire Insurance Company*, 174 F. 2d 799 (C. A. 3); *Kardon* v. *National Gypsum Company*, 69 F. Supp. 512 (E. D. Pa.); *Northern Trust Company* v. *Essaness Theatres Corporation*, 103 F. Supp. 954 (N.D. Ill.); *Hawkins* v. *Merrill, Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W. D. Ark.); *Robinson* v. *Difford*, 92 F. Supp. 145 (E. D. Pa); *Fry* v. *Schumaker*, 83 F. Supp. 476 (E. D. Pa); *Mills* v. *Sarjem Corporation*, 133 F. Supp. 753 (D. N.J.).

[2] 62 Stat. 930, as amended, 72 Stat. 415.

[3] *Cf. Montana-Dakota Utilities Company* v. *Northwestern Public Service Company*, 341 U. S. 246, which involved Sec-

were not "exclusive,"[4] it would seem that such an explicit grant of jurisdiction to a federal court would necessarily be controlling.

Since Rule 10b-5 defines manipulative and deceptive devices in the purchase and sale of securities, it is to be expected that violations thereof also might constitute conduct actionable under state law whether such causes of action are predicated upon common law fraud or statutory violation, state or federal. Indeed, Section 28 of the Securities Exchange Act provides that the "rights and remedies" provided by that Act are "in addition to any and all other rights and remedies that may exist at law or in equity". But Congress did not intend to permit the broad purpose of the Act, "to keep the channels of interstate commerce, the mail, and national security

---

tion 317 of the Federal Power Act, a jurisdictional section similar to Section 27 of the Securities Exchange Act. It was there held that the district court had jurisdiction over the subject matter of the suit. 311 U.S. 249. The quotation in the petition from that case (page 9) is wholly inapplicable to Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, which, unlike the provisions of the Federal Power Act there involved, are specifically designed to outlaw fraudulent conduct.

[4] Because federal jurisdiction is "exclusive," several state courts have refused to adjudicate violations of the Securities Exchange Act. See *e.g.*, *Mekrut* v. *Gould*, 188 N.Y.S. 2d 6, 9; *American Distilling Company* v. *Brown*, 51 N.Y.S. 2d 614, 184 Misc. 431, *affirmed*, 295 N.Y. 36, 64 N.E. 2d 317; *Standard Power & Light Corporation* v. *Investment Associates*, 29 Del. Ch. 593, 51 A. 2d 572, 579. For a discussion of the legislative history of Section 27 of the Securities Exchange Act, see *American Distilling Company*, *supra*, 51 N.Y.S. 2d 614.

exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation" in the purchase and sale of securities, to be frustrated by variations in state law.[5]

Although jurisdiction in this case was based on Section 27 of the Securities and Exchange Act, 15 U.S.C. 78aa, the ~~plaintiff~~ petitioner relies for the most part upon cases arising under 28 U.S.C. 1331. Even under that section, however, this Court has held that the fact that a plaintiff may have a choice to frame his complaint under state or federal law does not deprive the federal court of jurisdiction where the plaintiff elects to base his case upon federal law. *Bell* v. *Hood*, 327 U. S. 678, 681; *The Fair* v. *Kohler Die Company*, 228 U. S. 22, 25.

Petitioner also relies upon *Howard* v. *Furst*, 238 F. 2d 790 (C. A. 2) and *Brouk* v. *Managed Funds*, (C. A. 8), January 13, 1961. Without conceding

---

[5] *Hooper* v. *Mountain States Securities Corporation*, *supra*, 282 F. 2d at 202. The court there noted that Rule 10b-5 "greatly expands the protection frequently so hemmed in by the traditional concepts of common law misrepresentation and deceit, the requirement of privity, proof of specific damage, inadequacy of the right of rescission or right to recover up to par value of stock of a much greater market value. To these difficulties would have to be added the geographic obstacle of suit in a common forum against multi-state defendants scattered as far as the fraudulent device required." Id. at 201. Accord: *Connelly* v. *Balkwill*, 174 F. Supp. 49, 56 (N. D. Ohio). *Beury* v. *Beury*, 127 F. Supp. 786 (S.D. W. Va.), cited by petitioner (Pet. 7), is apparently to the contrary. The Court of Appeals for the Fourth Circuit, however, in the course of dismissing the appeal as not involving a final order, expressed by way of dictum its disagreement with the district court. See *Beury* v. *Beury*, 222 F. 2d 464, 465.

the correctness of those decisions, we submit they are clearly distinguishable from the present case, since they were not concerned with the provisions of the statute or rule here involved. *Howard* dealt with the Commission's proxy rules promulgated under Section 14(a) of the Securities Exchange Act, and held that the Act provided no cause of action in favor of a corporation, the directors of which had solicited its stockholders by proxy statements prepared in contravention of the proxy rules, concluding, as the petition notes (page 10), that the claim was solely "for violation of state-created rights, in no real or substantial sense dependent upon the provisions of the Securities Exchange Act of 1934 relative to proxy statements." (238 F.2d at 793.) In *Hooper v. Mountain States Securities Corporation*, *supra*, an action under Rule 10b-5, the Court of Appeals for the Fifth Circuit specifically refused to apply the language of *Howard* beyond the confines of Section 14(a).

In *Brouk*, where the court held that under the Investment Company Act of 1940 it had no jurisdiction over an action for damages against directors of an investment company, it nevertheless noted its agreement with the principles expressed in actions under Rule 10b-5, including *Hooper* v. *Mountain States Securities Corporation*, *supra*. See pages 14-16, 27 and 33 of the slip opinion.

The petitioner's contention (Pet. 8) that the decision of the court below conflicts with its prior decision in *Fratt* v. *Robinson*, 203 F. 2d 627, which also involved a private suit under Rule 10b-5, is errone-

ous. In *Fratt*, where a dismissal of the complaint was reversed, the court, as in the present action, held that the district court had jurisdiction over the subject matter pursuant to Section 27 of the Securities Exchange Act.* 203 F. 2d at 631-633. Since the Securities Exchange Act provides no statute of limitations for actions under Rule 10b-5, the court "borrowed" the state statute of limitations governing actions for fraud. This, however, is not the equivalent of making the suit itself a common law fraud action. As this Court said in *Textile Workers* v. *Lincoln Mills*, 353 U. S. 448, in the course of outlining the substantive federal law applicable to Section 301(a) of the Labor Management Relations Act:

> "Federal interpretation of the federal law will govern, not state law. * * * But state law, if compatible with the purpose of § 301, may be resorted to in order to find the rule that will best effectuate the federal policy. * * * Any state law applied, however, will be absorbed as federal law and will not be an independent source of private rights." (*Id.* at 457).

See also *Kemar* v. *Clayton Securities Corporation*, 81 F. Supp. 1014, 1017-1018 (D. Mass.).

---

* See also the Ninth Circuit's holding in *Errion* v. *Connell*, 236 F. 2d 447, 454.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.

WALTER P. NORTH,
General Counsel,

DAVID FERBER,
Assistant General Counsel,

JOHN A. DUDLEY,
Attorney,
Securities and Exchange Commission.

March, 1961.

☆ U. S. GOVERNMENT PRINTING OFFICE, 1961 587370 1032